



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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| Date: | 05/14/14 | Bill No: | Assembly Bill 769 |
| Tax Program: | Sales and Use | Author: | Skinner |
| Sponsor: | Author | Code Sections: | RTC 6356.9 |
| Related Bill: | | Effective Date: | Upon enactment |

BILL SUMMARY

Until July 1, 2015, or as specified, this bill provides a 3.9375% sales and use tax exemption for the first \$750 on a qualified efficient clothes washer purchased for installation and use in this state.

Summary of Amendments

The previous version of this bill was a Property Tax measure.

ANALYSIS

CURRENT LAW

Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law¹ imposes the sales tax on all retailers for the privilege of selling tangible personal property at retail in this state or the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer.

Current law imposes the sales or use tax on sales and purchases of appliances, including clothes washers, to the same extent as it imposes the tax on any other tangible personal property sales not otherwise statutorily exempted or excluded from tax.

California's sales and use tax rates. Since January 1, 2013, a statewide 7.5% sales and use tax rate applies to tangible personal property sales and purchases. The following table shows California's various sales and use tax rate components (the table excludes voter-approved city and county district taxes, which range from 0.1% to 2.5%):

| Rate | Jurisdiction | Purpose/Authority |
|---------|--------------------------------------|--|
| 3.9375% | State (General Fund) | State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3) |
| 1.0625% | Local Revenue Fund 2011 | Realignment of local public safety services (RTC Sections 6051.15 and 6201.15) |
| 0.25% | State (Fiscal Recovery Fund) | Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5) |
| 0.25% | State (Education Protection Account) | Until 01/01/17, schools and community college funding (Section 36, Article XIII, State Constitution) |
| 0.50% | State (Local Revenue Fund) | Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2) |

¹ Part 1 (commencing with Section 6001) of Division 2 of the Revenue and Taxation Code (RTC).

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| Rate | Jurisdiction | Purpose/Authority |
|-------|--|---|
| 0.50% | State (Local Public Safety Fund) | Local governments to fund public safety services (Section 35, Article XIII, State Constitution) |
| 1.00% | Local (City/County) 0.75% City and County 0.25% County | City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes |
| 7.50% | Total Statewide Rate | |

PROPOSED LAW

This bill provides a 3.9375% sales and use tax exemption for the first \$750 of the price of a qualified efficient clothes washer purchased for installation and use in this state.

The bill defines a “qualified efficient clothes washer” as any residential or commercial washer of a model that has been recognized by the United States Environmental Protection Agency (EPA) as meeting the agency’s performance requirements under the ENERGY STAR program, established pursuant to Section 6294a of Title 42 of the United States Code, and at the time of sale or purchase is included on the list entitled “ENERGY STAR Certified Residential Clothes Washers” or “ENERGY STAR Certified Commercial Clothes Washers” maintained by the agency.

This bill remains in effect until July 1, 2015, unless the Governor’s declared state of emergency regarding drought conditions is terminated before that date. In that event, the bill remains in effect only until midnight on the first day of the first calendar quarter commencing more than 60 days after the date the Governor terminates the state of emergency.

The bill also states legislative findings and declarations regarding California’s drought conditions and strategies that help communities respond to water scarcity.

As a tax levy, the bill becomes effective immediately upon enactment, but is operative on July 1, 2014.

IN GENERAL

ENERGY STAR is a joint program of the EPA and the U.S. Department of Energy to conserve energy and protect the environment through energy efficient products and practices.

In 1992, the EPA introduced ENERGY STAR as a voluntary labeling program designed to identify and promote energy-efficient products to reduce greenhouse gas emissions. Computers and monitors were the first labeled products. Through 1995, EPA expanded the label to additional office equipment products and residential heating and cooling equipment. In 1996, EPA partnered with the U.S. Department of Energy for particular product categories. The ENERGY STAR label is now on major appliances, office equipment, lighting, and home electronics. The EPA has also extended the label to cover new homes and commercial and industrial buildings.

The EPA’s ENERGY STAR website (<http://www.energystar.gov>) provides a listing of qualified ENERGY STAR products in various product categories, which includes, among other things, appliances such as clothes washers, dishwashers, refrigerators, and air conditioners.

To encourage individuals to buy energy efficient products, ENERGY STAR “partners” (manufacturers, local utilities, and state agencies) offer rebates on qualified ENERGY STAR products.

BACKGROUND

In response to California’s energy crises in the early 2000s, several bills were introduced during the 2001-02 Legislative Session to, among other things, provide a sales and use tax exemption for sales and purchases of various energy efficient appliances. None were sent to the Governor.

More recently, AB 150 (Smyth), considered in the 2009-10 Session, and AB 882 (Hernandez), in the 2007-08 Session, would have exempted all ENERGY STAR appliances sold on Earth Day each year. Both bills failed passage.

COMMENTS

1. **Sponsor and purpose.** The author is sponsoring this bill to help “...accelerate the replacement of older, less efficient clothes washers with more energy and water-efficient clothes washers, which significantly reduce household utility bills and reduce water usage amid the extensive and severe drought that California is facing.”
2. **The May 14, 2014 amendments rewrite the contents of the bill.** The previous version was a housekeeping measure which substituted the term “valuation date” for “lien date” in reference to selecting comparable sales to estimate a property’s value.
3. **Partial exemptions complicate retailers’ reporting obligations and tax administration.** Currently, most sales and use tax exemptions apply to the total applicable sales and use tax. However, California law contains various “partial” exemptions, similar to what this bill proposes, but with different exemption rates. For example, the law contains a 4.1875% exemption for certain equipment purchases by qualified persons engaging in manufacturing and research and development; a 5.25% exemption for sales of gas, and five 5.5% partial exemptions for specified sales and purchases of
 - (1) Farm equipment and machinery,
 - (2) Diesel fuel used for farming and food processing,
 - (3) Teleproduction and postproduction equipment,
 - (4) Timber harvesting equipment and machinery, and
 - (5) Racehorse breeding stock.

These partial tax exemptions complicate retailers’ return preparation and return processing. Return errors occur frequently with claimed partial exemptions. Accordingly, the BOE’s return processing workload increases.

Also, this bill proposes a new 3.9375% exemption rate. This requires a sales and use tax return revision with a new, separate return computation during the applicable exemption period. If enacted, some retailers may be required to segregate the 3.9375% clothes washer sales, the 4.1875% exempt manufacturing and research-related sales, the 5.50% exempt farm equipment sales, fully exempted sales (e.g., a sale for resale or interstate commerce sale), and fully taxable sales. This adds a new level of complexity, and potentially increases tax reporting errors. Accordingly, the BOE’s tax administrative functions and retailers’ reporting obligations become more complicated.

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4. **The proposed exemption applies to use tax transactions.** California consumers that order qualified efficient clothes washers from out-of-state, Internet, or mail order retailers will be entitled to the proposed partial exemption during the exemption period.

COST ESTIMATE

BOE will incur administrative costs related to notifying affected retailers, creating and distributing new sales tax charts and returns to affected retailers, addressing potential errors on returns, and answering inquiries from the general public affected retailers. A detailed cost estimate is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Residential & Commercial Energy Star Clothes Washers. The EPA collects ENERGY STAR unit shipment data annually to determine the products' market penetration and evaluate the program's overall performance. In fiscal year (FY) 2010-11, an estimated 4,884,500 residential washers and 76,500 commercial washers were shipped within the United States.

Using California's population, we estimate that 586,140 ($12\% \times 4,884,500$) residential washers and 9,180 ($12\% \times 76,500$) commercial washers were shipped to California.

Residential Washers. The 3.9375% exemption only applies to \$750 of the total selling price, for a \$29.53 maximum sales or use tax savings. Residential ENERGY STAR clothes washers come in several brands and models and with a broad range of prices, from \$379 to \$1,300. Sixty percent of two major retailers had ENERGY STAR residential washers priced above \$750. If we assume this 60% reflects the overall industry, then approximately 351,684 washers ($60\% \times 586,140$) sold would be subject to the maximum \$29.53 attributable to the partial sales and use tax exemption. This results in an estimated \$10.4 million sales and use tax loss ($\$29.73 \times 351,684$ washers = \$10.4 million).

We were unable to find the average price for washers sold for less than \$750. As an order of magnitude, we used \$400 as a price that would reflect lower-end models. Accordingly, the associated estimated sales and use tax loss would amount to \$3.7 million ($40\% \text{ of } 586,140 = 235,456 \text{ washers} \times \$400 \text{ price} \times 3.9375\%$).

For ENERGY STAR residential clothes washers, the total sales and use tax loss is estimated to be \$14.1 million.

Commercial Washers. Consumer buyer guides such as *CNET* and *Consumer Reports* indicate commercial washers are generally priced above \$750. Based on the estimated 9,180 commercial washers shipped to California, the sales and use tax loss is estimated to be \$271,085 ($\$29.53 \text{ maximum incentive} \times 9,180 \text{ washers}$).

Total Residential and Commercial Washers. Based on the FY 2010-11 data, total residential and commercial washers sales and use tax loss is estimated to be \$14.3 million. Therefore, adjusting for Department of Finance taxable sales forecast for FY 2014-15, total sales and use tax loss amounts to \$18.4 million.

REVENUE SUMMARY

The proposed 3.9375% sales and use tax exemption on ENERGY STAR residential and commercial clothes washers would result in an estimated loss of \$18.4 million in FY 2014-15.

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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